

## Truth in Lending Act: The homeowner's right to rescind

As the subprime market implodes, many home loans are in foreclosure or at the brink of it. As a result, an increasing number of homeowners are searching for ways to avoid foreclosure. One fruitful ground for them is the Truth in Lending Act ("TILA").

The purpose of TILA is "to assure a meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available to him and avoid the uninformed use of credit, and to protect the consumer against inaccurate and unfair credit billing card practices."<sup>1</sup> TILA and the implementing Federal Reserve Board Regulation Z regulate the content and presentation of loan agreements.<sup>2</sup> In that regard, TILA requires creditors to clearly and accurately disclose credit transaction terms.<sup>3</sup>

TILA allows a borrower to rescind a consumer credit transaction that is secured by an interest in his or her principal dwelling.<sup>4</sup> However, the borrower must exercise his or her right of rescission by midnight of the third business day following the consummation of the transaction or the delivery of the information and rescission forms together with material disclosures, whichever occurs later.<sup>5</sup> The lender must provide the borrower with a clear and conspicuous disclosure of the right to rescind before the transaction is completed. An effective and sufficient dis-

closure can protect the lender's financial interest in the transaction. If the lender does not give the borrower proper notice of his or her right to rescind, the rescission period extends from three days to three years, providing the borrower with an escape hatch from his or her commitment.<sup>6</sup>



David A.  
Scheffel

Congress has expressly stated that borrowers have no rescission rights "arising solely from the form of written notice used by the creditor to inform the obligor of the rights of the obligor under this section, if the creditor provided the obligor the appropriate form of written notice published and adopted by the Board, or a comparable written notice of the rights to the obligor, that was properly completed by the creditor."<sup>7</sup> In some instances, courts have found that adherence to the Federal Reserve Board's Model Form will bar a TILA claim entirely<sup>8</sup> or at least will serve as prima facie evidence of compliance with the disclosure requirement.<sup>9</sup>

Surprisingly, the Second Circuit has not addressed many issues arising out of TILA.<sup>10</sup> And, notably, it has not addressed the precise issue here: when may a borrower exercise his or her right to rescind a transaction due to improper notice under TILA.<sup>11</sup> As a result, district courts within this circuit have relied on authority in other circuits to resolve TILA claims in general and TILA non-disclosure claims in particular.<sup>12</sup> This creates

uncertainty when litigating there as circuit courts "are divided on whether 'technical' violations of TILA, such as the failure to fill in the date the rescission period expires on the notice provided to borrowers, impose liability on the lender or its assignee."<sup>13</sup>

Presenting one view, the First Circuit has recently stated in *Palmer v. Champion* that improper rescission notice claims under TILA must be analyzed objectively from the perspective of the reasonable consumer.<sup>14</sup> In that case, the rescission notices stated that, "[i]f you cancel by mail or telegram, you must send the notice no later than midnight of April 1, 2003 (or midnight of the third business day following the latest of [three listed events])."<sup>15</sup> However, the date certain stated in the clause elapsed before the borrower received the notice.<sup>16</sup> The borrower sought to rescind a year later claiming a TILA violation on the grounds that the notice was defective and confusing.<sup>17</sup> The First Circuit held that the rescission notice was not defective or confusing even though it did not state the specific date on which the right to rescind expired.<sup>18</sup> In so holding, the court explained that an objectively reasonable person would have grasped the meaning of the alternative deadlines and could have computed the actual deadline based on the passage of the three business days upon receipt of the notice.<sup>19</sup>

Presenting another view, other circuits have taken the position that technical or minor violations of TILA allow a borrower to

rescind years after a transaction. For example, the Ninth Circuit and the Fifth Circuit have held that the failure to fill in the expiration date for the three-day rescission period or the failure to deliver two copies of the rescission form allows a borrower the right to rescind up to the three year limit.<sup>20</sup> However, most decisions from these circuits that take this hard-line view of TILA violations predate Congress's amendment to TILA in 1996 in which it "rejected [a] hyper-technical view of TILA, by imposing a temporary moratorium on TILA class actions and then amending the statute out of concern that courts were 'allow[ing] plaintiffs to rescind a mortgage as a result of minor TILA violations.'"<sup>21</sup> And, notably, some of these decisions involved notices that did not mirror the Federal Reserve Board's Model Form.<sup>22</sup>

When confronted with a valid rescission notice, a lender must return to the borrower any money paid and must void the security interest in the borrower's property.<sup>23</sup> Failure to do so gives rise to a claim against the lender for damages.<sup>24</sup> And, for rescission to be fully effective under TILA, the borrower must return possession of the property to the lender.<sup>25</sup> And, notably, even when a borrower is permitted to rescind a transaction, courts routinely require him or her to tender the principal of the loan,<sup>26</sup> or other amounts due to the lender.<sup>27</sup>

To minimize the risk that lenders face under TILA, they should take steps to ensure compliance with the rescission notice requirements under this law. For example, they should conform their disclosure notices to the Model Forms provided by the Federal Reserve Board. And, their counsel at closing must ensure that borrowers receive proper notice of their right to rescind the transaction.

**David A. Scheffel is a senior associate in the commercial litigation department of Farrell Fritz, P.C. He is a former law clerk to U.S.D.J. Arthur D. Spatt of the Eastern District of New York.**

1. 15 U.S.C. § 1601(a).
2. See 12 C.F.R. § 226.
3. See *Beach v. Ocwen Fed. Bank*, 523 U.S. 410, 412 (1998).
4. 15 U.S.C. § 1635 (a); see also 12 C.F.R. § 226.15(a) ("In a credit plan in which a security interest is or will be retained or acquired in a consumer's principal dwelling, each consumer whose ownership interest is or will be subject to the security interest shall have the right to rescind: each credit extension made under the plan; the plan when the plan is opened; a security interest when added or increased to secure an existing plan; and the increase when a credit limit on the plan is increased.").
5. 15 U.S.C. § 1635(a).
6. See 12 C.F.R. § 226.15(a)(3); see also Elwin Griffith, *The Truth and Nothing But the Truth: Confronting the Challenge in the Truth in Lending Act and Regulation Z*, 40 Hous. L. Rev. 345, 370 (2003) (discussing the implications of a defective rescission notice).
7. 15 U.S.C. § 1635(h).
8. See *Santos-Rodriguez v. Doral Mortgage Corp.*, 485 F.3d 12, 15 n.5 (1st Cir. 2007) (stating "that there is statutory and case law support for the proposition that the model forms provide lenders a safe harbor protection whereby 'adherence to a model form bars a TILA non-disclosure claim entirely.'" (citing *Palmer v. Champion Mortgage*, 465 F.3d 24, 29 (1st Cir. 2006))).
9. See *Palmer*, 465 F.3d at 29 (stating a disclosure form that mirrors the Model Form of the Federal Reserve Board is "at the very least" prima facie evidence of adequate disclosure); see also *Jackson v. New Century Mortgage Corp.*, 320 F. Supp. 2d 608, 613 (E.D. Mich. 2004) (holding that the debtor did not adequately rebut the presumption that a disclosure form that mostly conformed with the Federal Reserve Board Model Form is insufficient).
10. See *Diaz v. Paragon Motors of Woodside, Inc.*, 424 F. Supp. 2d 519, 529 n.17 (E.D.N.Y. 2006) (noting the "general absence of applicable decisions" concerning TILA in the Second Circuit).
11. See *Rhodes v. Deutsche Bank National Trust Co.*, 07CV1544, slip op. at 11 (E.D.N.Y. Aug. 2, 2007) ("While the Second Circuit has not spoken on the issue, courts are divided on whether 'technical' violations of TILA, such as the failure to fill in the date the rescission period expires on the notice provided to borrowers, impose liability on the lender or its assignee.").
12. See *Diaz*, 424 F. Supp. 2d at 529 n.17 ("District courts in the Second Circuit have relied on authorities in other circuits with regards to claims arising under the Truth in Lending Act (TILA) due to the general absence of applicable decisions in this Circuit.") (citing *Ringback v. Crabtree Cadillac-Oldsmobile, Inc.*, 99 F. Supp. 2d 199 (D. Conn. 2000)); see also *Rhodes*, 07CV1544 at 11-13 (noting the conflicting views in the circuits regarding a borrower's right to rescind under TILA).
13. See *Rhodes*, 07CV1544 at 11.
14. See *Palmer*, 465 F.2d at 28 (analyzing alleged TILA non-disclosure claim under the standard of "whether the average consumer, looking at the notice objectively, would find it confusing.").
15. See *id.* at 26.
16. See *id.*
17. See *id.* at 26-27.
18. See *id.* at 28-29. Relying on *Palmer*, a court in the District of Massachusetts recently rejected a borrower's technical interpretation of TILA and held that notices, that closely track the Federal Reserve Board's Model Form, are clear and conspicuous even though they do not include the dates of transaction and the date of the expiration of the rescission period. See *Carye v. Long Beach Mortgage Co.*, 470 F. Supp. 2d 3, 9 (D. Mass. 2007).
19. See *Palmer*, 465 F.2d at 28-29.
20. See *Semar v. Platte Valley Fed. Sav. & Loan Ass'n*, 791 F.2d 699, 704 (9th Cir. 1986); *Williamson v. Lafferty*, 698 F.2d 767, 768-69 (5th Cir. 1983).
21. See *Santos-Rodriguez*, 485 F.3d at 17 n.6.
22. See *Semar*, 791 F.2d at 702; *Williamson*, 698 F.2d at 768.
23. See 15 U.S.C. § 1635(b) (requiring creditor to return any money or property given within 20 days of receipt of a notice of rescission).
24. See *Bellini v. Washington Mut. Bank*, 412 F.3d 17, 20 (1st Cir. 2005); see also 15 U.S.C. § 1640(a) (allowing a claim for damages against a creditor who fails to comply with the requirements under 15 U.S.C. § 1635).
25. See *id.* at 25 n.3 (stating that TILA altered common law rescission by requiring the creditor to tender before the debtor is obligated to do so, but also noting that the court has the power under TILA to change such procedures where the underlying facts support such procedural differences).
26. See *Berkeley Fed. Bank & Trust, FSB v. Siegel*, 247 A.D.2d 498, 499 (2d Dept 1998) (affirming decision to condition the borrower's right to rescind under TILA upon tender of the principal amount of the loan and that borrower's failure to do so would allow the lender to proceed with foreclosure action).
27. *Moazed v. First Union Mortgage Corp.*, 319 F. Supp. 2d 268, 272 (D. Conn. 2004) (holding that debtor's right to rescind may be predicated upon their tender to the lender of all the funds spent by the lender in discharging the debt).